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No.

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA
AND THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA,
Petitioners,

VS.

TENNECO OIL COMPANY, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Whether under section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b), as implemented by this Court in the *Phillips* case (*Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954)) and in the *Rayne Field* case (*United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965)), the Federal Energy Regulatory Commission has jurisdiction to prevent producers from collecting enormous amounts far in excess of applicable ceiling prices for vast, proven natural gas reserves which they dedicated to major interstate pipeline suppliers of California and other western states through lease-sale transactions that were the economic equivalent of producer sales contracts and that compelled the pipelines to engage in extensive developmental drilling immediately upon the closing of the lease-sale agreements.

LIST OF PARTIES

Public Agencies:

Federal

Federal Energy Regulatory Commission

State

People of the State of California
Public Utilities Commission of the State of California
Idaho Public Utilities Commission
Public Service Commission of Nevada
Public Utilities Commissioner of Oregon
Washington Utility & Transportation Commission
Public Service Commission of Wyoming

City

City of Ellensburg, Washington

Interstate Natural Gas Pipeline Companies:

El Paso Natural Gas Company
Northwest Pipeline Corporation

Distribution Companies:

Cascade Natural Gas Corporation
Colorado Interstate Gas Company
Intermountain Gas Company
Mountain Fuel Supply Company
Northwest Natural Gas Company
Pacific Gas and Electric Company
Rocky Mountain Natural Gas Company
San Diego Gas & Electric Company
Southern California Edison Company
Southern California Gas Company
Southern Union Company
Southwest Gas Corporation
Washington Natural Gas Company
Washington Water & Power Company

Producers:

El Paso's System	Party
GLA 47	Tenneco Oil Company Conoco, Inc.
GLA 51	Mapco, Inc. Hopi Oil Company
GLA 52	Tenneco Oil Company Conoco, Inc.
GLA 60	Tenneco Oil Company Conoco, Inc. Charles Colwill Anne Home Emerson, Trustee Anna Lou Home Jean E. Keyser Cassandra Keyser Teresa Home Barron Kidd Helen Ulmer van Atta
GLA 61	Sun Oil Company (Delaware)
GLA 62	FHN, Ltd.
GLA 63	Atlantic Richfield Company
GLA 66	W. Watson LaForce, Jr. Henry P. Isham, Jr. Estate Robert T. Isham Josephine C. Jacobson J. Roberts Jones Nancy LaForce Keyes Frederic P. G. Lattner, Trustee, U/T Martha M. Lattner, Settlor Suzanne LaForce Baber James C. Bard Douglas N. Bard Ralph A. Bard, Jr. Roy E. Bard, Jr. G. Brainard, Jr. Trust Continental Illinois National Bank and Trust Company, Trustee Trust #23935

El Paso's System	Party
	Continental Illinois National Bank and Trust Company, Trustee Trust #23949
	Eleanor Isham Dunne
	Charles W. Farnham, Jr.
	Robert B. Farnham
	Walter B. Farnham
	Elizabeth B. Farrington
	Minnie A. Fitting
	R. U. Fitting, Jr. Estate
	Robert D. Fitting
	Nancy H. Gerson
	John R. Grimes
	Ruth N. Halls
	Cortland T. Hill
	Elsie F. Hill
	Louis W. Hill, Jr.
	Albert L. Hopkins, Jr.
	George S. Isham
	R. S. MacDonald, A. MacDonald and Northern Trust Co., Trustees U/W of N.S. MacDonald, Deceased
	Mary F. Love
	William J. McDermott, Trustee
	Nora R. Ranney
	Catherine H. Ruml
	Edward L. Ryerson, Jr.
	Sabine Royalty Corporation
	Shaw, Isham & Company
	John I. Shaw, et al., Trustee
	James Simpson, Jr. Trust
	William E. Simpson Trust
	Sydney Stein, Jr.
	Northern Trust Co., Trustee, U/W of John Stuart Robert Douglas Stuart Estate
	William P. Sutter
	Michael Simpson Trust
	Patricia Simpson Trust
	Katharine I. White

El Paso's System	Party
	Kay B. Gundlach
	Frederick F. Webster Trust
	Mary S. Zick
	David Waller Dangler
GLA 72	Mapco, Inc.
	Hopi Oil Company
GLA 76	Union Oil Company of California
	First National Bank of Ft. Worth, Trustee for Eula May Johnston
	James J. Johnston
	V. A. Johnston Family Trust
	Jones Company
	Wm. C. McMahan Estate
	Homer R. Stasney & Sons Company
	Rogers-Gibbard Trust
GLA 77	Robert Beamon
	Robert Beamon, Trustee
	Pattie Ann Beamon Lundell
	Thomas L. Hall, Trustee
GLA 78	American Petrofina Company
	Tenneco Oil Company
	Conoco, Inc.
GLA 86, 101, 127	Mapco, Inc.
	Hopi Oil Company
GLA 106	Morris and Flora Mizel
GLA 122	Producing Royalties, Inc.
	Harold S. Long
	Dixie M. McLane, Trust
	Mrs. Judy St. John Taylor
	John S. White
GLA 125	American Petrofina Company
	Anderson Construction Company, Inc.
	Benson-Montin-Greer Drilling Corp.
	Tom Bolack
	Oliver Benson
	Albert R. Greer
	Mary Eddy Jones

El Paso's System	Party
	Edna Fern Benson
	Walter Benson
	Charlene K. Greer
	Mary E. Jones and The First National Bank & Trust Company of Oklahoma City, Trustees U/W of F. Jones
	Late Oil Company
	A. C. Montin, Jr.
	William V. Montin
	Oklahoma and Northwestern Company
GLA 129	Delta Drilling Company
	Trustees of the DeGolyer Foundation
	Mrs. Nell V. DeGolyer
GLA 139	Producing Royalties, Inc.
	James A. and Hazel H. Borland
	R. Lewis Chandler Trust
	Marcy C. Fannin
	Charles E. Graham, Jr.
	Newell R. Hays
	Dixie M. McLane Grandchildren's Trust
	Critchell Parsons
	Judy St. John Taylor
GLA 152, 160, 231	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
GLA 153	Gretchen A. Gartner
	Helen L. Harvey
GLA 157	Mapco, Inc.
	Barbara Ann Bruss
	O. J. Lilly
	Barbara Irene McConnell
GLA 172	Crown Central Petroleum Corporation
GLA 195	William G. Webb
GLA 196	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
	Benson-Montin-Greer Drilling Corp.

El Paso's System	Party
	Barbara Ann Bruss
	Charles Albert Greer
	La Plata Gathering System, Inc.
	O. J. Lilly
	Huerfanito Gas Co., et al., PP
	Barbara Irene McConnell
	Mary R. Boecking and H. E. Boecking, Jr., Trustees
	Jacqulyn M. Williams
GLA 197	Huerfanito Drilling Company, Inc.
GLA 198, 248	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
	Frank A. Schultz
GLA 249	Benson-Montin-Greer Drilling Corp.
	Barbara Ann Bruss
	Charles Albert Greer
	La Plata Gathering System, Inc.
	O. J. Lilly
	Barbara Irene McConnell
	Mary R. Boecking and H. E. Boecking, Jr., Trustees, U/T of Mary M. Strachley
	J. Glenn Turner
	Sue Reeder Turner Trust
	Jacqulyn M. Williams
GLA 348	Union Oil Company of California
	Jones Company
	W. C. McMahan
	H. R. Stasney & Sons Company
GLA 349	Union Oil Company of California
GLA 350, 351	Robert Beamon
	Robert Beamon, Trustee
	Thomas L. Hail, Trustee
	Pattie Ann Beamon Lundell

Northwest's System	Party
PLA 2	Atlantic Richfield Company
PLA 3	Getty Oil Company
PLA 4	Grace M. Brown
	Catherine B. McElvain, Inc. and as Executive of Estate of T.H. McElvain, Deceased
	T.H. McElvain Oil and Gas Properties
	James E. McElvain, Executor of Estate of Carl R. McElvain
	J. Wm. McElvain
	Estate of F.B. Miller
	Mabelle McElvain Miller
	Mrs. Ruth M. Vaughn
PLA 5	Phillips Petroleum Company
PLA 6	Amoco Production Company
	J. Ralph Ellis, Jr.
	Jones Felvey, II
	First National Bank in Dallas for the Acct. of J. Ralph Ellis, Jr.
	McCulloch Oil Corporation
	Mountain States Natural Gas Corp.
	John D. Mugg, Jr.
	Jack B. Ryan
	Texas Oil & Gas Corp.
	U. V. Industries
PLAs 7, 9, 10, 11	Amoco Production Company
PLA 8	J. Ralph Ellis, Jr.
	Jones Felvey, II
	First National Bank in Dallas for the Acct. of J. Ralph Ellis, Jr.
	H. M. Meredity Trustee and First National Bank of J. Ralph Ellis, Jr.
	Mountain States Natural Gas Corp.
	John D. Mugg, Jr.
	Amoco Production Company
	Jack B. Ryan
	Texas Oil & Gas Corp.
PLA 13	Mobil Oil Corporation
PLA 14	Champlin Petroleum Co.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners the People of the State of California and the Public Utilities Commission of the State of California (California) respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered on July 5, 1983.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 708 F.2d 1011 (1983) and is printed at Appendix 1a-19a.[1] The Court of Appeals reversed a decision of the Federal Energy Regulatory Commission (FERC) and affirmed a decision of a federal district court. The presiding Administrative Law Judge's (ALJ) Initial Decision on Jurisdictional Status of Lease-Sale Agreements, *El Paso Natural Gas Company,* Docket No. CP74-314, *et al.,* is reported at 12 F.E.R.C. ¶ 63,037 (1979), and is printed at App. 33a-120a. The FERC's Order Affirming Initial Decision and Initiating Further Hearing, *El Paso Natural Gas Company,* Docket No. CP74-314, *et al.,* is reported at 12 F.E.R.C. ¶ 61,296 (1980) and is printed at App. 21a-31a. The FERC's Order Denying Applications for Rehearing is reported at 13 F.E.R.C. ¶ 61,239 (1980) and is printed at App. 153a-54a. The decision of the district court, *El Paso Natural Gas Co. v. Sun Oil Co.,* is reported at 426 F.Supp. 963 (W.D. Tex. 1977) and is printed at App. 121a-36a. The Court of Appeals concluded in 1978 that it should not decide the appeal from the district court until it had the benefit of the FERC decision. This opinion and an order clarifying it are printed at App. 137a-44a. The opinion, *Tenneco Oil Co. v. FERC,* is reported at 580 F.2d 722 (5th Cir. 1978).

STATEMENT OF GROUNDS ON WHICH JURISDICTION IS INVOKED

1. The Court of Appeals for the Fifth Circuit concluded that the San Juan lease-sale transfers involved in this proceeding were not sales for resale under § 1(b) of

[1] California has filed a separate Appendix that contains all opinions issued in this matter and the judgment below. Hereinafter, the Appendix will be referred to as "App."

the Natural Gas Act, 15 U.S.C. § 717(b). In so ruling, the Fifth Circuit reversed a FERC determination that the transfers were in economic effect sales under section 1(b) and affirmed an earlier federal district court decision that the transfers were not sales under section 1(b). The FERC had jurisdiction pursuant to §§ 4, 5, 8, 14 and 16 of the Natural Gas Act, 15 U.S.C. §§ 717c, d, f, g, m and o. The district court had jurisdiction pursuant to 28 U.S.C. § 1331 and § 22 of the Natural Gas Act, 15 U.S. § 717u. The FERC, however, was not a party to the district court proceeding; the district court declined to refer the jurisdictional issue in this case to the FERC under the doctrine of primary jurisdiction.

2. The Court of Appeals entered judgments on July 5, 1983. App. 145a, 147a, 149a. The Court of Appeals denied rehearing on December 2, 1983. App. 151a-52a.

3. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and § 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

STATUTORY PROVISION INVOLVED

Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b) provides:

> The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

STATEMENT OF THE CASE

1. Statement of Facts

In 1938, Congress enacted the Natural Gas Act, 15 U.S.C. § 717 *et seq.*, to protect consumers against "exploitation at the hands of natural gas companies." *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 685 (1954). The present case involves natural gas producers who attempted to circumvent the Natural Gas Act in the 1950s and thereafter, while taking advantage of the tremendous increase in the need for natural gas in California.

Beginning in the late 1940s, demand for natural gas in California grew at a rapid pace to fuel the state's explosive growth in population and industrial development. *E.g.*, *San Juan Pipe Line Co.*, 9 F.P.C. 170, 178-79 (1950). California's main out-of-state source of natural gas was then the Permian Basin of west Texas. Since the San Juan Basin of New Mexico is closer to California than the Permian Basin, it was a much more ideal source of new supply. App. 44a-45a.

As of 1950, the San Juan Basin was already known as "one of the major fields of 'gas in place' in North America." R. 9936;[2] App. 106a. The two Mesaverde sandstones in the Basin were known to contain gas in great commercial quantities. App. 52a. In 1950, the Federal Power Commission (FPC), predecessor of FERC, authorized El Paso Natural Gas Company (El Paso), an interstate pipeline company and the largest supplier of natural gas for end

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[2] R. refers to the official FERC record.

use in California, to move gas from the San Juan Basin to California. App. 51a.

To meet the accelerated demand, El Paso sought large, additional supplies of natural gas for California in the San Juan Basin. In so doing, El Paso was compelled to deal with Delhi Oil Company (Delhi),[3] an oil and gas company which had assembled large acreage and vast, proven natural gas reserves in the San Juan Basin during the period 1950-1951. App. 57a.

Around this time, drilling activity was intense in the San Juan Basin, particularly in the Mesaverde sandstones. As of the fall of 1951, Delhi had fifteen (15) Mesaverde wells, App. 66a, and much of Delhi's acreage was surrounded by numerous Mesaverde wells. R. 9972. As of year-end 1951, there were 103 Mesaverde wells in the Basin. R. 9925.

By November 1951, Delhi had determined that 250 Mesaverde wells were needed to develop fully Delhi's undedicated[4] Mesaverde reserves, that these wells could be drilled within four (4) years, and that they could produce great quantities of natural gas. R. 9692.[5] Recognizing Delhi's

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[3]Tenneco Oil Co. and Conoco, Inc. are successors-in-interest of Delhi.

[4]"Undedicated" is a term of art meaning that the reserves were not committed or dedicated by prior contracts.

[5]Delhi estimated that these wells could produce 700 thousand cubic feet (Mcf) per well per day in early years, and that 1.063 trillion cubic feet (Tcf) could be produced at the rate of 14.9 billion cubic feet (Bcf) in year one (58 wells), 39.3 Bcf in year two (154 wells), 60.8 Bcf in year three (238 wells), and 63.9 Bcf in year four (250 wells) with production moderately declining thereafter. R. 9692.

Mesaverde reserves as the prime candidate to fulfill California's growing needs, El Paso began negotiating to purchase them from Delhi. App. 57a.

Delhi knew from prior experience, that if it sold the the reserves to El Paso under a conventional producer-pipeline contract, then it risked federal price regulation under the Natural Gas Act. App. 44a-51a, 59a-60a. So, Delhi devised a lease-sale contract that was the economic equivalent of the conventional sale and sold the gas pursuant to the gas lease-sale agreement (GLA).[6] See App. 25a.

Under the first transaction, known as GLA-47, Delhi assigned the leases, including the existing wells, to El Paso in return for El Paso's agreement to pay Delhi a "special overriding royalty" which started at 5.5¢ per Mcf with Delhi having the right in later years to obtain periodic redeterminations based on market value.[7] El Paso also paid Delhi for the existing wells and bore all remaining development costs and operating expenses.

Notwithstanding El Paso's responsibility for further developing these reserves, Delhi retained control over the development by imposing in GLA-47 a rapid development

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[6]The Fifth Circuit's opinion, below, did not dispute that these lease-sale agreements were the economic equivalent of conventional sales. App. 12a.

[7]Delhi's special overriding royalty was based upon its net interest (about 70%) in the gas reserves. R.4090, 4092-93. The original lessor had a conventional royalty interest and subsequent parties in the chain of title (before Delhi acquired the leases) reserved fractional overriding royalties in the production of the gas. Delhi's special overriding royalty was paid on the entire balance of the production (about 70%) after deducting the other royalty interests.

program on El Paso, which required El Paso to promptly develop the reserves, thus assuring Delhi of a large income stream as soon as possible.[8] App. 58a-59a.

Pursuant to its obligation, El Paso immediately began to develop these reserves and substantial supplies of gas were delivered into its interstate system.[9] Indeed, based largely on the GLA-47 reserves, in June, 1952, the FPC removed a limitation on deliveries from the San Juan area so that El Paso could deliver to California customers an additional 120,000 Mcf per day from sources in the San Juan Basin. *El Paso Natural Gas Co.*, 11 F.P.C. 1071, 1073-74 (1952).

GLA-47 became widely known in the Basin as the "Delhi" deal. App. 61a. Seeking to avoid federal regulation, other producers in the Basin insisted on similar terms as the Delhi deal and eventually sold their gas to El Paso under gas lease-sale agreements (GLAs). App. 61a-65a.

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[8]El Paso agreed to drill one Mesaverde well on each 320-acre undrilled location within five years or to release the drilling unit to Delhi. R.4099. It required no more than a month to spud and complete a Mesaverde well. R.5378 ("one well per month per rig"). El Paso agreed "as soon as possible" to tie the GLA-47 wells existing at closing and wells to be drilled pursuant to the development program into its gathering system. R.4101. This obligation continued until the reserves were producing at the rate of 100,000 Mcf per day. R.4101. Delhi required El Paso to keep six rigs in operation until such time as GLA-47 was producing 100,000 Mcf per day. R.4101-02. Because Delhi had rigs available, Delhi obligated El Paso to select Delhi as drilling contractor to drill 80 Mesaverde wells for El Paso's account. R.4099-100.

[9]GLA-47 was closed on March 1, 1952. El Paso extended its gathering system to take deliveries from three of Delhi's Mesaverde wells by the end of March. R.5241; R.5245; R.5147; App. 60a. By year-end 1952, 28 GLA-47 Mesaverde wells were delivering into El Paso's system; by year-end 1953, 104 GLA-47 Mesaverde wells were delivering into El Paso's system. R.5241-46.

Pacific Northwest Pipeline Corporation (PNW), predecessor to Northwest Pipeline Corporation (NWP), came into the Basin in 1952. App. 74a. To be competitive, it offered producers the option of selling their gas under a conventional sales contract or under a "Delhi" deal. App. 74a-75a. Not surprisingly, PNW acquired virtually all of its San Juan reserves under the lease-sale form. These are known as the "PLAs." PNW's pipeline from the Basin to the states in the Pacific Northwest was founded on PLA reserves. App. 74a-80a.

In the 1950s and 1960s, the special overriding royalty paid producers escalated to 10¢ per Mcf. Until 1973, the producers did not seek to redetermine their special overriding royalty at market value. Then, Sun Oil Company (Sun), one of the producers, demanded an increase to market value. App. 40a. When El Paso rejected its demand, Sun invoked the arbitration clause in its GLA. A Board of Arbitrators in 1973 awarded Sun a special overriding royalty of 40¢ per Mcf. App. 40a. This massive increase in the price of natural gas had a snowballing effect as other producers sought to take advantage of the Sun award by claiming that they were entitled to favored nations treatment pursuant to their GLAs or sought an increase through arbitration themselves. App. 40a-44a.

2. Proceedings Below

In 1973, El Paso brought suit in a federal district court claiming that the GLAs were in economic effect sales of gas, and hence jurisdictional under this Court's opinion in *Rayne Field (United Gas Improvement Co. v Continental Oil Co.*, 381 U.S. 392 (1965)). El Paso sought to enjoin the arbitrations being pursued by the producers and requested

that the court refer the jurisdictional issue to the FPC under the doctrine of primary jurisdiction. California intervened in support of El Paso. Northwest Pipeline Corporation (NWP) intervened in early 1974. In 1974, El Paso filed a complaint with the FPC and in that complaint requested that the FPC determine the jurisdictional issue. California again intervened. NWP filed a similar complaint.

In 1974, El Paso undertook to settle its contract dispute with the producers. California did not participate in these negotiations and had not even been informed of them until after the agreements (known as the "1974 Settlement Agreements") had been reached. Pursuant to the 1974 Settlement Agreements, El Paso agreed to pay the producers, beginning June 1, 1974, a special overriding royalty of 40¢ per Mcf and further agreed to redetermine the level of this payment each June 1, with the payment per Mcf to equal the *highest* rate of general applicability prescribed by the FPC or successor agency less 7 cents per Mcf. In these agreements, the parties recognized that El Paso would continue to litigate the jurisdictional issue and were therefore aware that in the event El Paso prevailed on the jurisdictional issue, the amount paid, beyond what the FPC determined to be just and reasonable, would be subject to refund. Until October 1, 1983, El Paso has at all times included the special overriding royalties and its full costs of production as components of its cost of service and collected from its customers, and ultimately California ratepayers, the amount needed to pay these costs. However, after this Court's decision in *Public Service Commission of New York v. Mid-Louisiana Gas. Co.*, ...U.S....., 103 S.Ct. 3024, 77 L. Ed. 2d 668 (June 28, 1983) limited El Paso to the maximum lawful prices under the Natural Gas Policy

Act of 1978 (NGPA), 15 U.S.C. §§ 3301, *et seq.*, El Paso has now deemed the GLA wells to be unprofitable and has taken action to reassign the wells to the producers pursuant to a provision in the GLA agreements.[10]

Paying the bulk of these special overriding royalties, California has since 1973 sought a final ruling that the GLA transactions were in economic effect sales under the Natural Gas Act and therefore subject to FPC (now FERC) regulation.

In the action brought by El Paso in the federal district court, the court never acted on the motion that the court refer the jurisdictional issue to the FPC under the primary jurisdiction doctrine. Instead, the court in 1977 ruled that the lease-sale transfers were not jurisdictional under *Rayne Field* and its progeny. App. 121a-36a. Following the district court's decision, the FPC initiated an investigation on El Paso's complaint. In 1979, FERC Administrative Law Judge Benkin, in a comprehensive opinion, determined that the lease-sale transfers were jurisdictional under *Rayne Field* and its progeny. App. 33a-120a. In 1980 the FERC affirmed the opinion (App. 21a-31a) and denied rehearing. App. 153a-54a.

While the district court's and the FERC's decisions were being appealed, the FERC instituted remedy proceedings to determine the proper rates for the GLA and PLA gas and the amount of refunds due El Paso and NWP, which would ultimately be passed on to the ratepayers. App. 153-54a.

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[10]The producers are contesting this reassignment in state court litigation presently underway in the District Court, 11th Judicial District, Harris County, Texas.

Because the 1974 Settlement Agreements had tied the level of special overriding royalty payments to the highest regulated rate of general applicability and such rates escalated rapidly, especially with the advent of NGPA pricing in 1979, the amounts paid as special overriding royalties by El Paso and NWP (and ultimately the ratepayers) increased dramatically over the years since 1974. Consequently, California (as well as FERC staff) estimate that from 1974 through 1982 ratepayers on El Paso's system alone have been overcharged in excess of $1 billion, including interest on the overcharges, and are entitled to refunds in that amount.[11] After over two (2) years of hearings and discovery, the FERC remedy proceeding trial was set for September, 1983.

On July 5, 1983, the Court of Appeals for the Fifth Circuit, reviewing both the District Court's and the FERC's decisions, ruled that the lease-sale transfers of natural gas were not jurisdictional.[12] App. 1a-19a. The Court agreed with the FERC that the San Juan lease-sale transactions were in economic effect similar to that of a

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[11]California bases its estimate on valuing the gas at the applicable Natural Gas Act and NGPA rates, deducting El Paso's cost of production and paying to the GLA producers those values less cost. For example, since 1979, El Paso has paid these producers at the NGPA § 102 rate for new gas (15 U.S.C. § 3312) less 7 cents when much of the gas would be considered NGPA § 104 flowing gas (15 U.S.C. § 3314) if the GLAs were jurisdictional and properly regulated. The significance of this discrepancy is readily apparent when considering that as of June 1, 1982, the § 102 new gas rate was $3.44/MMBtu and the § 104 flowing gas rate was $.52 MMBtu. Of course, the producers do not agree with this proposal and have offered their own proposal in the FERC remedy proceedings.

[12]The FERC remedy proceeding has consequently been suspended.

conventional sale. App. 12a-14a. The Court also agreed with the FERC that the gas volumes were proven when the GLA/PLA agreements were made. App. 15a. The Court did not challenge the FERC's finding that the development wells drilled shortly after transfer enabled the pipelines to take the gas in great quantities to supply western markets, especially California. The Court ruled, however, that the lease-sale transfers were not jurisdictional because the development drilling was to be done by the pipeline after closing, rather than by the producers before closing. App. 15a-16a.

In so ruling, the Fifth Circuit stated the "Commission's downplaying of the development issue may well foreshadow the next stage in the evolution of the law" (App. 15a) but stated that it was precluded by this Court's opinion in *Rayne Field* from holding that lease-sale transfers were jurisdictional in the absence of substantial development drilling. App. 15a-16a. Under the Fifth Circuit's holding, the FERC's jurisdiction over the economic equivalent of a producer wellhead sale is made to turn on the extent of development (as opposed to exploratory) drilling, even though the producer controls the timing of development in the lease-sale agreement. As a consequence, an important class of wholesales of natural gas is exempt from FERC regulation under the Natural Gas Act.

On December 2, 1983, the Court of Appeals denied all petitions for rehearing, including those filed by the FERC, California, El Paso, and other parties. App. 151a-52a.

REASONS FOR GRANTING THE WRIT

Whereas consumers in most of the states have significantly benefited from the pricing protection under the Natural Gas Act for wholesales of natural gas, the decision of the Court of Appeals has deprived consumers in the western states, especially California, of such protection with respect to an enormous supply of natural gas transported to them from the San Juan area. The Court of Appeals' reversal of the FERC decision, which had attempted to redress this inequitable and inconsistent result, has created a void in the FERC's jurisdiction in contravention of this Court's leading decisions on the Natural Gas Act and the very purpose of the Act itself.

If the GLAs are found to be jurisdictional sales of gas, the FERC remedy phase, which was near trial when the decision below was issued, would fix the amount to be refunded by the producers. Under the FERC staff's and California's theory of remedy, the GLA producers should be required to refund over $1 billion (including interest) for excessive amounts paid to them between 1974 and October 1, 1983, with California consumers as the main beneficiaries of such refunds.

In addition to denying any relief for these past overcharges, the decision below has caused great uncertainty over the future of this gas supply. The decision below, along with this Court's decision in *Public Service Commission of New York v. Mid-Louisiana Gas Co.*, ... U.S. ..... 103 S.Ct. 3024, 77 L.Ed.2d 668 (June 28, 1983), has led to El Paso's current litigation to reassign the wells. Depending upon the outcome of that litigation and related

FERC proceedings, California is threatened with the possible loss of a vast supply of natural gas or excessive future prices for this gas.

This case is of exceptional importance because the decision below exempts a class of wholesales of natural gas from regulation, greatly impairs the integrity and proper administration of the Natural Gas Act, leaves California and other western states with no remedy for the enormous overcharges paid by their consumers in recent years, and creates great uncertainty in the years ahead.

THE DECISION BELOW CONFLICTS WITH THIS COURT'S LEADING CASES ON THE SCOPE OF THE NATURAL GAS ACT

The Court of Appeals' construction of the Natural Gas Act is irreconcilable with this Court's leading cases on the scope of the Natural Gas Act. In 1954, this Court in the *Phillips* case (*Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954)) ruled that independent producer sales were sales for resale within the meaning of section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b). The promise of *Phillips* was that *all* wholesales of natural gas in interstate commerce were to be regulated. 347 U.S. at 682. A decade later, in the *Rayne Field* case (*United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965)), where it came to this Court's attention that producers could accomplish the equivalent of a producer sale through a sale of leases, the Court held that such a lease-sale was also within section 1(b). The Court enforced as to lease-sales the promise of *Phillips* that *all* wholesales of gas in interstate commerce were under regulation. 381 U.S. at 402.

The decision below erroneously relies on *FPC v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949) ("*Panhandle*"), the principal case that was distinguished in *Rayne Field*. In *Rayne Field*, this Court limited *Panhandle's* holding strictly to its facts—the transfer by an interstate pipeline of leases covering an undeveloped field to a production company for ultimate sale and consumption in *intrastate* commerce. Nevertheless, the *Panhandle* case was an important influence on the decision below, despite this Court's treatment of it in *Rayne Field*.

So far as is now known, the lease-sale transfers in the San Juan area were the first attempt by the gas producing industry to evade the FPC's jurisdiction. They were mostly entered before this Court settled in *Phillips* that the FPC had jurisdiction over producer sales, but at a time that the industry anticipated that the decision in *Phillips* might ultimately be unfavorable. App. 47a-49a. Delhi believed that the Barker Dome and then the GLA-47 lease-sales were not subject to regulation under the *Panhandle* case. It received legal opinions to that effect. App. 49a and 60a.

In rejecting the FERC's decision that the San Juan lease-sales were clearly jurisdictional, the Court of Appeals was persuaded to the contrary because it read this Court's decision in *Rayne Field* as requiring substantial pre-agreement development drilling before a lease-sale could be jurisdictional. App. 15a-16a. California maintains that this was not the intent of the *Rayne Field* decision.

Rayne Field involved sales of leases from a proven field that was also substantially developed by wells. In *Rayne Field*, this Court distinguished *Panhandle* from *Rayne Field* on two grounds: first, that the leases in *Panhandle*

were not substantially developed; second, that *Panhandle* did not involve a sale of natural gas for resale in interstate commerce. 381 U.S. at 403-404. The decision below placed undue emphasis on the first ground of distinction. This Court in *Rayne Field* was not called upon to focus on the fact that lease-sales, in economic effect the equivalent of conventional sales, can be structured where the development drilling has not yet been done; all that is needed is sufficient exploratory drilling on or off the acreage to be made the subject of the lease-sale so that reasonable estimates can be made of the recoverable gas volumes underlying the acreage to be assigned. The cost of development wells is then one of several factors that is taken into account in structuring the consideration of the lease-sale. Still, the lease-sale involves a wholesale of gas regardless of the extent or even the existence of development wells.

Since *Phillips* and *Rayne Field* made clear that Congress intended to regulate all wholesales of gas without exception, it is apparent that wholesales where the development drilling remains to be done are just as jurisdictional as where such drilling has been substantially done before transfer. This is especially true in the present case wherein the substantial development had purposely been temporarily postponed pending sale of the reserves.[13] In view of the GLAs' requirement that El Paso immediately develop the properties, the flow of gas was clearly imminent at the time the agreement was reached. Whether substantial development occurs before the lease-sale agreement is made or immediately upon the closing of the lease-sale, as in the present case, in either situation the lease-sale has

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[13]See discussion, *infra*, p. 20.

"accomplished the transfer of large amounts of natural gas to an interstate pipeline for resale in other states. That is the significant and determinative economic fact. To ignore it would substantially undercut Phillips . . . ." 381 U.S. at 401. The reason, of course, is that it would leave unregulated a major class of wholesales of gas in interstate commerce resulting in the very exploitation of consumers by natural gas producers which the Natural Gas Act was enacted to prevent. *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. at 685.

The decision below sharply criticizes the FERC's "economic equivalency/commercial realities approach." App. 14a. However, this is exactly the approach that is required under *Rayne Field*. 381 U.S. at 401. In criticizing the FERC, the Court of Appeals ignored its own prior acknowledgment in *Louisiana Land and Exploration Co. v. FERC*, 574 F.2d 204 (5th Cir. 1978), *cert. denied*, 439 U.S. 1127 (1979) that "[E]conomic realities . . . determine whether a jurisdictional sale has occurred." 574 F.2d at 207. The lease-sale format, first before this Court in *Rayne Field*, was developed by the San Juan producers to avoid FPC regulation. *See* App. 44a-51a, 88a. Because the San Juan lease-sales were the economic equivalent of conventional sales, the FERC's' careful jurisdictional determination was clearly correct.

THE DECISION BELOW CONFLICTS WITH CLEAR PRIOR PRECEDENT THAT DEVELOPMENT DRILLING IS NOT REQUIRED TO ACCOMPLISH A JURISDICTIONAL SALE

The decision below asserts that "the Commission's downplaying of the development issue may well foreshadow the next stage in the evolution of the law . . . ." This is not true. In fact, it has been clear to the industry for a long time that the FERC's jurisdiction does not depend on the extent of development drilling. The FPC in several cases in the 1960s made it clear that this was not the intent of *Phillips* and later *Rayne Field*. The history is reviewed in the Initial Decision, *Tennessee Gas Pipeline Co.*, 38 F.P.C. 703 at 721-23 (1966). The industry tested the FPC's position in one of these cases and it lost. See *Continental Oil Co. v. FPC*, 370 F.2d 57 (5th Cir. 1966), *cert. denied*, 388 U.S. 910 (1967) ("*Ship Shoal*"). Judge Wisdom's *Ship Shoal* opinion is a landmark decision, and clearly applied the *Rayne Field* principle to new fields, where the development drilling remained to be done.

In *Ship Shoal*, at the time the lease-sale was entered, there was but one gas well, seven oil wells, and four dry holes. The many gas reservoirs required at least four more gas development wells[14] in order to develop all of them. Under the lease-sale, the development cost was shifted to the pipeline, along with the operating expense. Initial

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[14]These wells were deep, offshore wells. Such wells are far more costly to drill and operate than the relatively shallow onshore wells in the San Juan Basin.

Decision, *Tennessee Gas Transmission Co.*, 30 F.P.C. 798, 802-03 (1963). The producers argued at every stage that the *Ship Shoal* reserves were not "substantially developed" because the development drilling remained to be done. Judge Wisdom acknowledged that the development drilling remained to be done (370 F.2d at 66), but found jurisdiction because the lease-sale accomplished the transfer of large amounts of substantially proven reserves, containing definable gas volumes, to an interstate pipeline for resale in interstate commerce, with payment geared to production. *Ship Shoal*, 370 F.2d at 67.

In *Ship Shoal*, the Fifth Circuit devised the "commercial quantities" test (see App. 95a-97a) precisely because of the absence of substantial development in *Ship Shoal*, as the producers therein noted with enthusiastic dissatisfaction in their certiorari petition to this Court.[15] Here, the evidence showed that the GLA-47 reserves were more imminently producible upon development than *Ship Shoal* upon development—Delhi anticipated that El Paso could produce 16.8% (179 Bcf) of the GLA-47 reserves in four years (R.9692) whereas the producers' witness estimated that 10% (73 to 82.3 Bcf) of the *Ship Shoal* reserves could be depleted in four years. 370 F.2d at 66. As shown in the Statement of the Case, the GLA-47 reserves were immediately attached upon closing, development drilling proceeded at a fast pace, and substantial volumes were moving to California within a short time. No comparable facts

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[15]Petition for cert. at pp. 7-10, *Continental Oil Co. v. FPC*, No. 1323, October Term, 1966.

existed in *Ship Shoal*, which was held to be a jurisdictional sale.[16]

The decision below did not consider *Ship Shoal* in light of its facts, and hence did not come to grips with the holding of that decision that substantially proven reserves (without development wells) are enough to accomplish a jurisdictional transfer. 370 F.2d at 67. Rather, according to the decision below, the FERC's jurisdiction depends on the extent of development drilling, yet development drilling often does not take place under either a conventional sale or an equivalent lease-sale until the producer has entered into a contract with a pipeline. Sensibly enough, the producer is not going to invest his capital in development wells until the pipeline is obligated by contract to take the gas and the producer can look forward to a return of his investment, as well as profit.[17] App. 110a-111a. Further, as the present case has dramatically established, a producer controlling a large volume of gas desperately needed in a market area can extract a very high price through the

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[16]Indeed, in *Ship Shoal*, the producers advised this Court not only that the pipeline "would be compelled to proceed with development work following transfer" but also that it could not even "determine until later whether to construct the connecting pipeline depending on the results from further drilling to determine feasibility." Petition for cert., cited in n. 15, *supra*, pp. 9-10.

[17]For example, in the San Juan Basin, Stanolind Oil & Gas Co., the producing arm of Standard Oil of Indiana, entered into a long-term sales contract to sell Mesaverde gas to El Paso in April, 1950. Stanolind initially planned to dedicate 17,320 acres to its contract with El Paso. As of January 1, 1950, DeGolyer and MacNaughton, independent reservoir engineers, estimated that these 17,320 acres contained recoverable reserves of 515 Bcf. R. 9715. At that time, there were two Mesaverde wells on the 17,320 acres.

lease-sale form (as easily as the producer could in a conventional sale) unless restrained by regulation.

Above all, just as proven but undeveloped reserves dedicated under conventional sales contracts are concededly jurisdictional, so also development drilling is not needed to effect a jurisdictional lease-sale. Regulatory effectiveness clearly requires that the FERC exercise jurisdiction over both types of contracts. The FPC and the Fifth Circuit recognized in the 1960s that this was a necessity. As ALJ Benkin wrote in this case:

"The *Rayne Field-Bastian Bay*[18]*-Ship Shoal* trilogy represented a major victory for the FPC. It firmly closed the door upon efforts to use the lease-sale contract as a device to evade the agency's jurisdiction over wellhead sales, including (most importantly) the agency's power to establish ceiling prices for all gas sold to the interstate market." App. 97a-98a. The decision below is a devastating throwback to a regulatory era that was meant to end forever with this Court's decision in *Phillips*.

CONCLUSION

The decision below has sanctioned the circumvention of the Natural Gas Act by certain producers with total disregard to the basic principle that has guided this Court in *Phillips* and *Rayne Field*, the Fifth Circuit in *Ship Shoal*, and the FPC (and FERC) for the last two decades: namely,

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[18]In *Bastian Bay*, which was before this Court at the same time as *Rayne Field*, this Court *summarily* reversed the Tenth Circuit's non-jurisdictional decision. *FPC v. Pan American Petroleum Corp.*, 381 U.S. 762 (1965).

that all wholesales of natural gas in interstate commerce are subject to pricing protection.

Because natural gas wholesales involve a market where end use consumers are largely captive customers, the Natural Gas Act was enacted to prevent exploitation by natural gas producers. Yet the Court of Appeals' decision has deprived millions of consumers of any redress for the past overcharges as well as future protection for prices for this gas notwithstanding Congress' intention to give consumers such remedies.

California therefore respectfully submits that this petition for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit should be granted.

Respectfully submitted,

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